

Canada

AR52

Development

Corporation

Annual

Report



A major strategic review led us to focus primarily on our holdings in petroleum, sulphur and petrochemicals. Our major goal is to create additional value by emphasizing operating excellence and global competitiveness.

Financial Highlights

(millions except per share amounts)

Canada Development Corporation

	Year ended December 31	1986	1985	1984
1 Report of Directors	Revenue	\$2,625.1	\$2,960.1	\$2,831.3
4 Canterra Energy Ltd.	Canterra			
7 Polysar Limited	Operations before writedowns	(13.2)	88.8	46.0
10 Other Corporate Investments	Writedown of property, plant & equipment	(270.7)	—	—
12 Financial Review	Polysar	22.1	(6.7)	29.0
17 Summary of Accounting Policies	Corporate and other	(24.7)	(24.2)	(28.6)
18 Financial Statements	Income (loss) from operations	(286.5)	57.9	46.4
21 Notes to Financial Statements	Results of non-consolidated subsidiaries and affiliates	(7.5)	(14.2)	(14.8)
27 Auditor's Report	Gain on investments	10.8	127.2	49.5
28 Five-Year Financial Summary	Net income (loss)	\$ (283.2)	\$ 170.9	\$ 81.1
30 Investor Information	Per common share			
31 Directors and Officers	Income (loss) from operations	\$ (9.06)	\$ 0.13	\$ 0.02
32 Other Information	Net income (loss)	\$ (8.97)	\$ 3.17	\$ 0.98

Canada Development Corporation is a private sector enterprise whose common shares trade on the Toronto, Montreal and Vancouver exchanges (Symbol: CDC). It has operating assets in petroleum and sulphur through Canterra Energy Ltd. (96 percent owned) and in primary, intermediate and related downstream petrochemicals through Polysar Limited (100 percent owned). Its principal equity investments are Falconbridge Limited, a major multinational mining company, and CDC Life Sciences Inc., a Canadian-based health-care company.

Report of Directors

To our shareholders:

The past year was one of major change for CDC. Among other things, it marked a significant transition in the Corporation's ownership following the successful completion by the federal government of a public offering of 21.8 million common shares from its holdings. This sale of the government's shares has broadened CDC's shareholder base and increased its private-sector ownership to more than 85 percent.

The year also marked a change in the Corporation's direction. A major strategic review of our investments and financial conditions was undertaken and a decision was made to focus primarily on the Corporation's holdings in petroleum, sulphur and petrochemicals. Thus, we accelerated our disposition program, raising more than \$300 million through the sale of assets that were no longer considered strategic and used the proceeds to reduce corporate debt. We will seek to strengthen our financial position by realizing on our remaining non-strategic assets in the short-to-medium term. However, our major goal is to create additional value by emphasizing operating excellence and global competitiveness in our core holdings.

Review of 1986

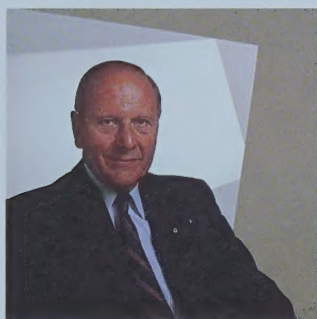
For CDC, the generally positive economic environment was overshadowed by the collapse in the price of oil and continued turmoil in the office automation market. The earnings growth from CDC Life Sciences as well as the return to profitability by Polysar were not sufficient to overcome the decline in operating profit at Canterra as well as an unsatisfactory performance from AES Data. Gains in divestitures completed during 1986 were more than offset by loss provisions made at the end of the year for assets still on our disposition list, and by a major adjustment to the carrying value of Canterra's assets.

The loss from continuing operations during 1986 was \$15.8 million. After the results of non-consolidated subsidiaries and affiliates, gains on investments and non-cash cash writedowns, CDC's 1986 net loss was \$283.2 million, compared with net income of \$170.9 million in 1985.

These results should not overshadow the year's positive accomplishments at both the corporate and operating levels. At the corporate level, the most significant achievement was the reduction in CDC's long-term debt to \$625.6 million from \$900.3 million in line with our goal announced in last year's annual report.

In operations, Canterra reacted quickly to the sharp decline in the price of oil by reducing staff, salaries and capital expenditures, and was able to lower its net indebtedness by about \$100 million despite the unfavourable environment. Canterra's abilities in exploration and enhanced oil recovery were demonstrated once again: for the fifth successive year, the company increased its petroleum reserves after production.

Polysar benefitted from lower energy prices and made substantial progress toward sustained profitability in its basic petrochemical business. A favourable business purchase enabled Polysar to establish a profitable position in polystyrene in the United States, making it one of the top three companies in this area.



Pierre Côté
Chairman

In our other investments, CDC Life Sciences continued its outstanding sales, product development and financial performance; a successful primary and secondary share offering broadened the market for CDC Life Sciences. Our remaining interest in Falconbridge provides CDC with a convertible equity interest in an efficient mining company with a diversified slate of metals. Allelix continued to make solid progress in its research and long-range development projects in biotechnology.

Planning for the future

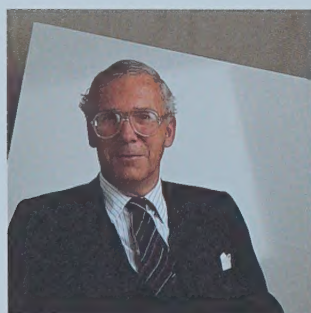
Important challenges lie ahead for CDC and its operations. During 1987, the Corporation will place emphasis on making further improvements to the operating performance of its core assets in petroleum, sulphur and petrochemicals. A decision has been made to dispose of AES Data and Savin and the Corporation may realize on its remaining holdings in Falconbridge and CDC Life Sciences if suitable opportunities present themselves.

Our planning for the future recognizes the importance of a consistent operating performance, and the need to improve the Corporation's capital structure. Our philosophy will be to emphasize further productivity gains and cost reductions throughout the group. Capital will be allocated to meet our twin objectives of remaining successful leaders in our chosen areas and improving our financial position.

Canterra is directing its energies to remaining a highly successful and low-cost explorer for petroleum reserves and an efficient producer in Western Canada. In sulphur, it will seek to maintain its position as a market leader in full knowledge that world consumption continues to exceed production even during short-lived periods of weakness in demand.

Polysar can look forward to improved profitability from basic petrochemicals and plastics, as well as continued solid performance from its rubber and latex businesses. Good progress is being made in commercializing its high-margin and technically intensive products, in expanding into the Asia-Pacific region and in reducing the impact of price swings in the commodity segments of its business.

CDC's petroleum, sulphur and petrochemical assets provide a good base on which to build a prosperous future. However, CDC's growth in recent years has been largely financed using coupon-bearing capital – both debt and preferred equity. Financial charges, even in a period of reasonable interest rates, absorb a higher portion of operating cash flow than is desirable, restricting the amount available for reinvestment. Profitable operations and the further sale of non-strategic assets, when combined with the conversion of preferred shares and the issue of common equity on suitable terms, will over time improve the financial structure of the Corporation.



H. Anthony Hampson
Deputy Chairman and
Chief Executive Officer

CDC faces the future with a streamlined portfolio, efficient operations and the prospect of a stronger equity base. With a reasonable economic environment, the Corporation can provide its shareholders with more consistent and sustained returns from their investments.

People

Earlier this year, H. Anthony Hampson, who has been associated with CDC since before its inception, announced his decision to step down as Chief Executive Officer effective May 1, at which time Bernard F. Isautier, who was appointed President and Chief Operating Officer in September, will succeed him. We thank Mr. Hampson most warmly for the energy and determination that he brought to the Corporation during more than 15 years of challenge and growth under his leadership.

During the year, Laurent Beaudoin resigned as a director after 15 years of service, including many years on the Audit and Executive Committees. We will also be saying farewell to two other directors – Philippe de Gaspé Beaubien and Allan Waters – who served on the Communications and Executive Committees respectively and who will not be standing for re-election at this year's Annual Meeting. Mr. Waters has been a director since CDC's inception in 1971 and Mr. Beaubien since 1974. All of these gentlemen have served CDC with distinction and made valuable contributions to its progress over the years.

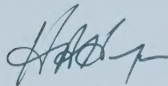
In closing, we would like to extend our personal thanks and best wishes to all people in the CDC group for their efforts during the past year. The future will be challenging but we are confident that it will be a rewarding one as we continue our mission of increasing value for our shareholders.

Respectfully submitted on behalf of the Board,



Pierre Côté

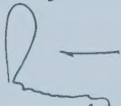
Chairman



H. Anthony Hampson

Deputy Chairman and

Chief Executive Officer



Bernard F. Isautier

President and

Chief Operating Officer

March 19, 1987



Bernard F. Isautier
President and
Chief Operating Officer

Canterra Energy Ltd.

The rapid decline in the price of oil during early 1986 had a serious impact on the financial performance of Canterra Energy Ltd. (95.7 percent owned). The negative environment overshadowed several positive accomplishments, including a record increase in reserve additions, a reduction of long-term debt and lower operating costs.

During the past year, the company reported a loss from operations of \$17.7 million compared with record results during 1985 of \$86.9 million. Its decision to stop capitalizing interest on frontier properties in 1986 reduced earnings by \$18.4 million. Canterra's free cash flow declined to \$174.1 million in 1986, compared with \$310.4 million for 1985. Consolidated revenue for 1986 was \$577.5 million, down \$188.4 million from year-earlier figures.

Like many other Canadian petroleum companies, Canterra reduced the carrying value of its Canadian frontier and U.S. oil and gas properties at the end of 1986 because of low oil prices. As well, the company also reduced the carrying value of its coal holdings and real estate properties. These non-cash writedowns totalled \$355.5 million (after tax) of which CDC's share was \$270.7 million. For 1986, Canterra contributed a loss of \$283.9 million to CDC, compared with a positive contribution of \$88.8 million for 1985.

Canterra recorded reserve additions for oil and natural gas in excess of production. Additions and revisions amounted to 4.3 million cubic metres for oil and liquids or 255 percent of 1986 production and 3.2 billion cubic metres for natural gas or 165 percent of production. These reserve figures do not include Canterra's substantial resources in the Canadian frontier. Sulphur additions and revisions were 65 percent of sales.

Canterra holds a significant interest in one of the most significant gas discoveries in the Western Canadian Basin in the past 20 years. Canterra holds interests varying from 4.1 per cent to 87.5 per cent, averaging 27.8 per cent in 15 sections in the discovery area near Caroline in west central Alberta. Modest reserves of gas, gas liquids and sulphur were booked in 1986 as a result of Canterra's interest. More substantial reserve bookings are expected in 1987 with the commencement of delineation drilling.

Because of its reduced cash flow from operations, Canterra moved quickly during 1986 to trim capital spending, effectively ceasing exploration in the United States, cutting activity in the Canadian frontier, limiting spending on oil sands and heavy oil, and tightening criteria for conventional exploration. Canterra invested \$168.4 million in exploration and production activities during the past year of which \$57.5 million was covered by various government programs, leaving net expenditures of \$110.9 million, down from \$213.9 million in 1985.

Long-term debt was reduced by \$27.9 million in 1986. The company raised \$217.5 million through long-term financing during the past year, using the proceeds to extend maturities by prepaying loans which would otherwise have matured in 1987 and 1988.

Canterra Energy Ltd.

Financial results

(millions)

	1986	1985	1984
Revenues	\$ 577.5	\$ 765.9	\$ 610.1
Free cash flow	\$ 174.1	\$ 310.4	\$ 187.1
Total assets	\$3,331.8	\$3,784.8	\$3,497.6
Contribution to earnings (loss) before non-cash write-downs	\$ (13.2)	\$ 88.8	\$ 46.0
Write-down of property, plant and equipment	(270.7)	—	—
Contribution to CDC	\$ (283.9)	\$ 88.8	\$ 46.0

Western Canada Exploration

Canterra's exploration programs are largely concentrated in Western Canada where the lower oil price has reduced industry activity, which has resulted in lower drilling and land costs. Finding costs were reduced to only \$3.92 per barrel in 1986 reflecting Canterra's concentration on higher-quality projects, lower land costs and drilling expenses, and internal cost-control programs. Exploration activity during the year was concentrated in the Rainbow Lake, Shekilie and Fire areas of northern Alberta, Pouce Coupe and Monias-Boudreau in the Peace River area and in west central Alberta. Hydrocarbon reserves added through successful exploration programs replaced 70 percent of 1986 production.

Frontier Exploration

The company is maintaining its interests in those frontier areas where petroleum resources can be developed in the foreseeable future using present technology. A lower level of exploration activity is expected in the frontier during the short-to-medium term. Since Canterra began frontier exploration activity in 1981, it has built a strong position in land and discoveries off the Canadian east coast. Its frontier properties were written down to \$94.5 million (\$439.5 million at the end of 1985) and include important and valuable positions in such discoveries as Terra Nova off Newfoundland, and the Thebaud gas field off Nova Scotia. During 1986, Canterra participated in 13 wells, which resulted in 5 gas and 3 oil discoveries. Canterra will maintain investment spending to protect discovered frontier resources for future commercial development.

Western Canada Production

New exploratory and development wells brought on stream by Canterra in Alberta during 1986 added production of more than 500 cubic metres per day of oil and 500,000 cubic metres per day of gas. A number of projects increased oil production at Rainbow Lake, where injection of natural gas and natural gas liquids is being carried out to optimize oil recovery. New pipeline connections facilitated the tying in of six new oil wells in the Shekilie and Virgo areas in northwestern Alberta to the Rainbow and Interprovincial pipeline systems.

The capacity of the natural gas pipeline system from the Blackstone-Stolberg gas field to the Ram River plant was increased late in the year. Canterra plans to place on production a second Blackstone well in 1987, thus doubling the deliverability of the pool. This new pool qualifies for one-year royalty-free status under Alberta regulations.

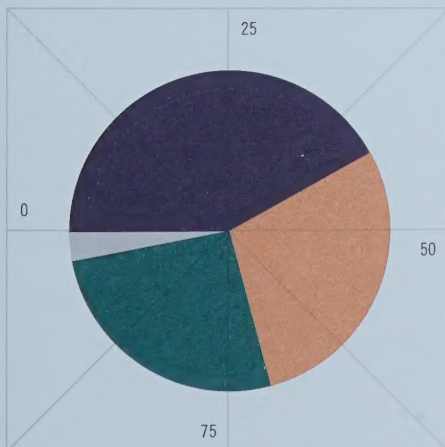
A sulphur reclamation facility at Ram River is scheduled to start production in mid-1987 to process basepad and other sulphur that has been contaminated in storage and handling operations.

Marketing

Gross volumes of conventional crude oil and natural gas liquids produced and sold were down 9 percent from 1985, largely due to capacity constraints on Interprovincial's main pipeline transmission line, a situation that is expected to ease during 1987 as expansions are completed. The average price received for Canterra's oil and liquids production in 1986 was \$19.40 per barrel (\$35.29 per barrel in 1985).

With deregulation, a variety of price mechanisms are available to marketers. Canterra used a mixture of them to optimize return and reduce price volatility during 1986. Through a combination of sales at refiner-posted prices and through futures contracts, Canterra realized an average oil price that was equivalent to the prices paid by the major Canadian refiners.

Canterra Energy Ltd.
Breakdown of sales*



Total revenue \$551.7 million

- Sulphur 42%
- Oil and natural gas liquids 29%
- Natural gas 26%
- Coal 3%

* net of royalties

Natural gas volumes produced and sold in 1986 were largely unchanged from 1985. The average price was \$82 per thousand cubic metres during 1986 (\$96 per thousand cubic metres in 1985). More than 90 percent of Canterra's natural gas sales are delivered to traditional buyers under long-term contracts. About 59 per cent of their commitments to purchase gas were realized during 1986, compared with 63 per cent in 1985. Canterra's deliveries during 1986 represented approximately 55 per cent of its developed capability. The Canadian natural gas industry is expected to continue to operate below capacity until export markets expand.

Canterra is actively pursuing direct sales to distribution companies and end users in Canada and the United States. During 1986, it began sales to Polysar Limited at a negotiated price. Selling Canadian gas into U.S. markets continues to be restricted by U.S. regulations limiting access to major pipeline systems. However, Canterra expects to achieve substantial increases in revenue from the sale of natural gas in future periods through higher sales into the United States because of rapidly declining U.S. domestic supplies. This will be accomplished by new direct sales as well as through increased rates of take under existing contracts.

Sulphur

After record years in 1984 and 1985, the Canadian sulphur industry recorded a 15 percent decline in sales volumes in 1986. This was the result of a financially weakened agricultural sector and a large grain surplus throughout the world which reduced consumption of phosphate fertilizer, a large user of sulphur. Canterra's sales reflected overall industry performance with volumes of 1.7 million tonnes in 1986, compared with more than 2.1 million tonnes in each of the two previous years. Canterra's average selling price in 1986 of \$142 per tonne after transportation charges was unchanged from 1985. Canterra owns about 15 percent of world's above-ground sulphur inventories, an important strategic asset for the company as demand continues to exceed supply.

Other Activities

Production from Canterra's Athabasca tar sands pilot plant in northeastern Alberta increased 25 per cent from 1985. The Alberta Oil Sands Technology and Research Authority (AOSTRA) will fund 100 per cent of operating costs at the pilot project in 1987 and 1988. Results to date at this project have been very encouraging, and two additional years of testing will significantly advance the technology to allow for a better assessment of commercial viability.

In the United States, lower prices for oil and gas and a decline in production resulted in reduced cash flow. Because of the price decline, oil and gas exploration was significantly reduced by Canterra in the U.S. in 1986.

Weak demand and increased productivity resulted in continued oversupply and soft coal prices in eastern U.S. markets. The company intends to dispose of its U.S. coal operations.

Outlook

An improved financial performance at Canterra is possible with increased rates of take on natural gas presently under contract, new gas production from recent exploration discoveries and firmer prices for oil, natural gas and sulphur. The company has established a debt reduction target of \$800 million over the next five years, using cash provided from operations and the disposal of its non-strategic assets where appropriate. Canterra's strong cash flow will provide for this repayment of indebtedness as well as financing exploration and development programs in Western Canada that should allow the replacement of most of its annual production in future periods.

Polysar Limited

CDC owns 100 percent of Polysar Limited, a Canadian-based international petrochemical company and the world's largest producer of synthetic rubber and latex. Polysar is based in Sarnia, Ontario, and has 22 plants in six countries. It is also a major North American producer of polystyrene, basic petrochemicals and fuel products. Its customers in over 90 countries are manufacturers of a wide range of products, including automotive tires and parts, plastic products, coated paper, adhesives and carpets.

During 1986, Polysar increased its profitability despite a 7 percent decline in revenues that was due to lower selling prices for many of its products arising from falling oil prices. Continuing management efficiency and quality improvement programs should lead to further improvements in financial returns to CDC. Revenue in 1986 was \$2 billion, while contribution to CDC totalled \$22.1 million after payment of preferred dividends, compared with a negative contribution of \$6.7 million the previous year.

A major disappointment during the year was an unfavourable court decision regarding the contract dispute with Ontario Hydro. Polysar is appealing this decision and expects a more favourable outcome.

In operations, all businesses performed above expectations in 1986. The basic petrochemicals group, which includes the Petrosar plant acquired in mid-1985, became profitable late in 1986 – a significant turnaround from the heavy losses experienced in recent years. The rubber and latex businesses had record earnings and plastics showed a sharp improvement in its financial performance.

Underlying the improved performance at Polysar were a number of factors – both management actions and external circumstances. Polysar's strategy of moving into higher-value production resulted in the withdrawal from the unprofitable Sarnia general purpose styrene-butadiene (SBR) rubber business and the acquisition of polystyrene resins business of a large company leaving the business during 1986. The conversion of the Petrosar petrochemical plant to crack natural gas liquids to increase feedstock flexibility – and decrease Polysar's exposure to erratic crude oil markets – was completed ahead of schedule and under budget. To focus on expanding the company's business in the high growth Asia-Pacific region, a business development team was put in place and a regional office established in Singapore.

These and other management actions allowed Polysar to capitalize on several external factors that included moderate economic growth, a major decline in feedstock prices resulting from falling world oil prices, the downward movement of North American currencies on foreign exchange markets, and higher prices for some important commodity products.

Polysar Limited

Financial results

(millions)

	1986	1985	1984
Revenues	\$2,047.6	\$2,193.6	\$2,218.4
Net income	\$ 27.8	\$ 0.1	\$ 35.9
Contribution to CDC	\$ 22.1	\$ (6.7)	\$ 29.0
Free cash flow	\$ 89.8	\$ 17.4	\$ 26.4
Total assets	\$2,399.5	\$2,468.1	\$2,490.2

Basic Petrochemicals

Sales in 1986 of \$601 million from the basic petrochemicals group accounted for about 30 percent of Polysar's total revenue. This group produces such petrochemicals as ethylene, propylene and styrene, as well as a range of fuel products. The Corunna plant (formerly Petrosar) supplies approximately 40 percent of the primary petrochemicals consumed by Polysar's other North American operations.

During 1986, basic petrochemicals overcame severe challenges. This group's mandate was to integrate and return the Petrosar operations to profitability. During the first half of the year, severe pressure was placed on margins because inventories contained finished goods manufactured from higher-priced feedstocks after the world price for crude oil declined. In the second half, however, the cost of crude oil in inventory reflected the lower feedstock costs and margins improved. By the fourth quarter, management actions directed towards productivity improvements and rationalization, continued low feedstock prices and improved selling prices for styrene enabled the group to report a profit contribution to Polysar.

Continued economic growth is leading to higher capacity utilization in the North American petrochemicals industry. The higher selling prices for several commodity products promises to provide continued margin improvement for Polysar's basic petrochemicals group during 1987. Further efforts are being made to reduce costs and improve efficiency.

Rubber

The rubber group remained the main source of income for Polysar in 1986, accounting for 41 percent of 1986 revenue (\$847 million in 1986 compared with \$840 million in 1985) but a higher proportion of income. While results from the company's North and South American rubber operations were significantly improved, they were below the European business. About 85 percent of the group's sales are to companies in the automotive industry, a market changing to lower volume products with higher technical content. Specialized products, such as oil and heat-resistant rubbers, are used in hoses and seals for the automotive market and modifiers for plastics.

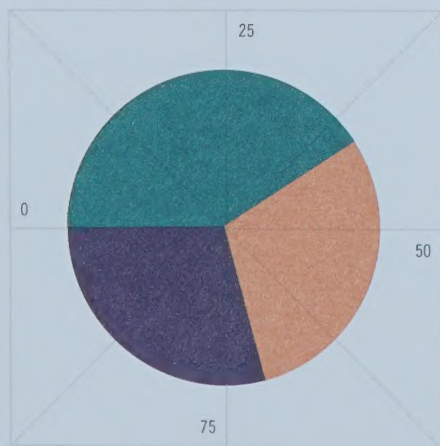
Revenues remained comparable to 1985 but gross margins increased because of lower raw material and energy costs and favourable currency movements. Across all rubber operations, increased emphasis on improving efficiency in both production and administration had a positive influence on results.

Ending production of general purpose grades at the Sarnia SBR facility is typical of Polysar's move out of commodity rubber and into more specialized – and more profitable – products. The rubber group will continue to concentrate on improving quality and productivity to maintain margins. For the longer term, the rubber group is stressing research and technological development in both the product and process areas.

Diversified Products

This group, which includes the latex, plastics and specialty products divisions, contributed revenue of \$587 million or 29 percent of Polysar's total sales, up from \$507 million or 23 percent in 1985.

Polysar Limited
Breakdown of revenue



Total revenue \$2.0 billion

- Rubber 41%
- Basic petrochemicals 30%
- Diversified products 29%

Sales and volumes for latex were unchanged over 1985 but, because of lower feedstock prices, profits improved. North America was again the major source of income. While European markets for latex foam used as carpet-backing – the division's major product – continued to shift, a substantial increase in profitability occurred. A pattern of strong growth, coupled with the continuing development of new applications, should result in strong growth for Polysar's latex business over the longer term.

The plastics division enjoyed favourable business conditions in 1986 and began showing a profit in the second quarter. Volumes for the year increased by about 45 percent, in large part because of the acquisition of additional capacity. The 1987 outlook is positive because of the broadened base of business. This division expects to continue operating at high capacity and, through its technology thrust, develop new products, applications and processes.

Although not yet a major contributor to profits, the specialty products division's mandate is to build some of Polysar's smaller, specialized businesses and find new opportunities for growth.

Asia-Pacific

Formed during 1985 to develop Polysar's business in the world's fastest growing economic region, this group was responsible for \$107 million of sales in 1986. During the year, it established its main office in Singapore and opened a joint venture latex plant in Shanghai. Currently, it is concentrating on marketing and business development and will shortly begin to develop manufacturing capacity to serve other developing markets in the region.

Outlook

Polysar made important progress in 1986. Many problem areas have been improved through effective management actions. The results of the company's strategy are illustrated by improvements in profits and cash flow. Further improvement in financial performance during 1987 and beyond will also serve to reduce its debt load. Polysar will maintain its course – emphasizing quality and efficiency to become a recognized market leader in all its businesses and move steadily towards higher value-added products through technological leadership.

CDC Life Sciences Inc.

Following a successful public offering in Canada and the United States during 1986, CDC's interest in CDC Life Sciences was reduced to 25.2 percent. A combined offering of 7.4 million shares from CDC's holdings and 2.5 million from treasury raised \$133.2 million for CDC and \$45.0 million for CDC Life Sciences.

CDC Life Sciences has been a very successful investment for CDC. The secondary offering during 1986 resulted in a pre-tax gain to CDC of \$100.4 million. An earlier offering of shares in the company resulted in a pre-tax gain of \$21.2 million, which was reflected in CDC's 1984 financial results. CDC still holds 5.5 million common shares of CDC Life Sciences and now accounts for its interest as a minority equity investment, recording in income 25.2 percent of the company's net earnings.

During 1986, CDC Life Sciences had a strong financial performance, with earnings rising 35 percent on revenue growth of 53 percent over 1985. All three business areas of CDC Life Sciences improved their results during 1986. Connaught Laboratories Limited experienced strong demand for its vaccine products in the U.S. market. The clinical research and drug analysis business of Bio-Research Laboratories Ltd. expanded significantly during 1986, absorbing almost all of the new capacity brought on stream during 1985, while the pre-clinical business was able to improve margins from a greater proportion of specialty studies. And 35.4 percent owned Nordic Laboratories increased its revenue during 1986 by 51 percent as a result of continued growth of its two leading products, Cardizem® for the treatment of angina and Sulcrate® for duodenal ulcers.

Falconbridge Limited

As a result of the sale of Kidd Creek in late 1985, CDC obtained a significant minority equity position in Falconbridge consisting of 10.5 million common shares and a \$271 million debenture convertible into an addition 12.3 million shares. During 1986, CDC sold all its common share holding in Falconbridge through an offering of almost 7 million units consisting of one common share and a one half Deferred Payment Right. A full Deferred Payment Right entitles the holder to purchase one of CDC's remaining 3.5 million Falconbridge common shares before the end of 1987 for \$19.75. Each of the 7 million units were sold for \$20.25, raising a total of \$141.4 million for CDC. When the Deferred Payment Rights are exercised by the end of 1987, CDC will receive another \$69.0 million for total proceeds of \$210.4 million. CDC retains its debenture, which represents a 15 percent voting interest in Falconbridge if converted.

For 1986, Falconbridge had a consolidated loss before extraordinary items of \$15.5 million, compared with earnings of \$38.5 million during 1985. Revenues for 1986 were \$1.1 billion, up from \$890.0 million in 1985, largely as a result of the acquisition of Kidd Creek which Falconbridge purchased from CDC. While zinc and gold prices increased during the second half of 1986, copper and nickel deteriorated as the year progressed and had a significant negative impact on Falconbridge's results.

The company generated extraordinary income during 1986 through the sale of equity interests in Kiena Gold Mines Limited, Giant Yellowknife Mines Limited, Akaitcho Yellowknife Gold Mines Limited and Corporation Falconbridge Copper. When extraordinary items are included, Falconbridge had 1986 earnings of \$70.3 million.

Allelix Inc.

CDC has a 50 percent investment in Allelix Inc., which is one of Canada's leading companies developing products and processes based on the new biotechnologies. The company's scientific programs are shaped by market research which has identified attractive business opportunities in agriculture, diagnostics and specialty chemicals.

Allelix's first and most advanced product is a high-yielding spring hybrid canola seed which is being developed for sale in Western Canada. Canola is a source of edible vegetable oils for the food and feed industry worldwide and is Canada's third-largest field crop, valued at about \$1 billion. Allelix has also developed growth-promoting soil inoculants, a fungal production system for producing novel industrial enzymes for the food and detergent industry and an over-the-counter pregnancy test.

During 1987, Allelix intends to further focus its research in a number of key areas and seek equity financing for further development and commercialization of its products.

CDC Data Systems Limited

In early 1987, CDC announced that its wholly-owned subsidiary, CDC Data Systems, was considering the sale of its office automation investments, which include AES Data Inc. (100 percent owned), Savin Corporation (58 percent owned) and Insystec Inc. (100 percent owned). With this decision, CDC reduced the carrying value in the 1986 financial results of its investment in CDC Data Systems and its subsidiaries through a non-cash writedown of \$46.0 million to reflect an impairment in its value.

Subsequently, agreement in principle was reached to sell AES to CPT Corporation of Minneapolis, Minn. Both AES and CPT design, manufacture and market a full line of complementary office automation products. The combination of AES's distribution organizations in Europe and Canada with CPT's sales force in the United States is expected to create a stronger world market presence that can compete more aggressively and effectively.

Savin continued to make progress in returning its operations to profitability. However, the company's 1987 performance will depend on its continuing ability to improve revenues in the competitive market for copier products.

In early 1987, Insystec ceased operations and CDC is endeavouring to sell the technology developed by the company for an integrated voice and data office automation product.

Sentrol Systems Ltd.

In two separate transactions during the past year, CDC sold its interest in Sentrol to Valmet Corporation of Finland. Sentrol specializes in sensor-based supervisory control systems for the paper industry, as well as other products for pipeline control, water management, steel mills and battery manufacturing. The combination of Sentrol and Valmet is expected to strengthen both companies' positions in the worldwide industrial automation industry.

Financial Review

Overview

CDC's major objective is to maximize value for its common shareholders by concentrating on improving earnings from the operations of its core activities in petroleum, sulphur and petrochemicals, as well as increasing the value of its other investments.

During 1986, income from operations declined as a result of sharply reduced oil prices and sulphur volumes, which negatively affected the results of Canterra. The benefit from lower world oil prices in the form of reduced feedstock costs and better margins at Polysar was not enough to offset the negative impact at Canterra. Because of the uncertain outlook for world oil prices, Canterra reduced the carrying value of its frontier exploration properties in Canada and its oil and gas, coal and real estate assets in the United States in its 1986 financial results.

During the past year, CDC took a number of actions to streamline its asset base, reduce indebtedness and improve financial flexibility. These actions continued during 1987 and their purpose is to position CDC for improved performance in the future. During 1986, these actions included:

- completing the sale of Kidd Creek Minerals Ltd. to Falconbridge Limited, obtaining from this transaction \$140 million of cash, 10.5 million common shares and a \$270.8 million debenture convertible into 12.3 million common shares;
- selling a royalty interest in the Nanisivik mine for \$11 million;
- disposing of 10.5 million Falconbridge common shares in a two-part public offering with \$136.2 million net received during the past year and an additional \$69 million expected in 1987;
- receiving \$125.7 million net from the sale of common shares of CDC Life Sciences, reducing CDC's interest from 66.8 percent to 25.2 percent;
- withdrawing from the industrial automation business through the sale of Sentrol Systems Ltd. for \$34.2 million;
- disposing of further venture capital holdings by selling interests in Onex Capital Corporation and Oncap Holding Corporation for \$17.2 million; and
- selling by private placement 4 million CDC common shares with share purchase tax credits for \$28 million net.

As a result of these transactions, CDC ended 1986 with long-term indebtedness at the corporate level of \$625.6 million, down significantly from \$900.3 million. In early 1987, CDC's program to streamline its operations and improve its financial position continued with:

- a public offering of CDC common equity to raise \$30 million of cash to finance Canterra's 1987 Canadian petroleum exploration program; and
- the announcement that CDC will dispose of AES Data and Savin Corporation.

Operations

For the 12 months ended December 31, 1986, CDC had a net loss of \$283.2 million, primarily as a result of asset write-downs at Canterra. This compares with net income of \$170.9 million. Revenue in the latest period was \$2.6 billion, down from \$3.0 billion in 1985 as a result of the impact from lower petroleum prices.

Revenue Summary (millions)

Year ended December 31	1986	1985	1984
Canterra	\$ 577.5	\$ 765.9	\$ 610.1
Polysar	2,047.6	2,193.6	2,218.4
Corporate		0.6	2.8
Total	\$2,625.1	\$2,960.1	\$2,831.3

Included in the 1986 financial results was CDC's after-tax share of reductions totalling \$270.7 million made by Canterra in the carrying value of its Canadian frontier and U.S. oil and gas assets, its coal holdings and certain real estate properties, as well as a non-cash write-down of \$46.0 million in the carrying value of investments held by CDC Data Systems and other write-downs of \$21.1 million. The 1986 results also included gains of \$67.9 million from the sale of common shares of CDC Life Sciences and \$8.8 million from the disposition of Sentrol.

Contribution Summary
(millions)

Year ended December 31	1986	1985	1984
Canterra			
Operations before write-downs	\$ (13.2)	\$ 88.8	\$ 46.0
Write-down of property, plant and equipment	(270.7)		
Polysar	22.1	(6.7)	29.0
Allelix	(3.2)	(3.8)	(2.7)
Corporate	(21.5)	(20.4)	(25.9)
Income (loss) from operations	(286.5)	57.9	46.4
Results of non-consolidated subsidiaries and affiliates	(7.5)	(14.2)	(14.8)
Gain on investments	10.8	127.2	49.5
Net income (loss)	\$ (283.2)	\$ 170.9	\$ 81.1

After payment of preferred dividends, the loss to common shareholders was \$340.2 million or \$8.97 per common share for 1986, compared with net income to common shareholders of \$117.8 million or \$3.17 per common share for 1985.

At Canterra, sharp declines in prices for crude oil and natural gas during 1986, together with lower sales volumes for petroleum and sulphur, resulted in a loss from operations before write-downs of \$13.2 million for the year. Natural gas sales volumes increased approximately 2 percent above 1985 levels, while oil and liquids and sulphur volumes were down 4 percent and 17 percent respectively. Canterra's operating costs for the year were \$164.8 million, down from \$179.9 million in 1985 as a result of lower sales volumes and sulphur purchases and cost-cutting actions taken by the company during the year in response to business conditions.

Approximately 79 percent of the pre-tax write-down of property, plant and equipment by Canterra was directly related to its oil and gas properties in Canada and the United States, and was determined by the application of the accounting guideline issued by the Canadian Institute of Chartered Accountants known as the "Ceiling Test."

Polysar returned to profitability during 1986 with consolidated net income of \$22.1 million, compared with a loss of \$6.7 million in 1985. The improvement in performance was due mainly to the decrease in crude oil prices which had a favourable impact on all profit margins through lower feedstock costs; stronger foreign currencies resulting in record earnings from European operations; and the acquisition of a U.S. plastics business which, when combined with higher selling prices for polystyrene, improved returns from this area.

Lower crude prices during 1986 had the greatest impact on Polysar's Corunna operations, formerly Petrosar Ltd., where a significant improvement in financial performance occurred. Polysar's basic petrochemical operations, which include the Corunna facility, experienced higher profit margins, operating cost reductions and lower feedstock prices.

CDC's annual funding of Allelix and administrative expenses at the corporate level remained largely unchanged during the past year. However, the significant asset sales during the year began to have a positive impact on corporate overhead during the 1986 fourth quarter.

Results of Non-Consolidated Subsidiaries

In its financial results for 1986, CDC deconsolidated CDC Life Sciences as a result of its reduced equity ownership, as well as AES and Sentrol as a result of their dispositions. The operations of CDC Life Sciences, AES, and Sentrol have been deconsolidated from the financial results for 1985 and 1984 for comparability as was Kidd Creek to reflect its sale and Savin Corporation as a result of operating losses that reduced the book value of the Corporation's equity investment to zero.

Results of Non-Consolidated Subsidiaries and Affiliates*

(millions)

Year ended December 31	1986	1985	1984
CDC Life Sciences	\$ 10.8	\$ 8.2	\$ 8.4
CDC Data Systems	(17.1)	(33.4)	(38.6)
Sentrol	(1.2)	(1.2)	(1.5)
Kidd Creek	—	12.2	16.9
Total	\$ (7.5)	\$(14.2)	\$(14.8)

*CDC share

Gains on Investments

During 1986, CDC sold in a public offering 7.4 million common shares from its holding of CDC Life Sciences, resulting in an after-tax gain of \$67.9 million. The sale of Sentrol and Onex during the past year resulted in after-tax gains of \$8.8 million and \$1.1 million respectively.

Gain on Investments

(millions)

Year ended December 31	1986	1985	1984
CDC Life Sciences	\$100.4		\$ 21.2
Kidd Creek		\$145.4	
Canterra		19.9	
Sentrol	8.8		
Other	2.6		39.7
Provision for losses			
CDC Data	(46.0)	(50.8)	
Other mining assets	(15.9)		
	49.9	114.5	60.9
Income taxes	(39.1)	12.7	(11.4)
Total	\$ 10.8	\$127.2	\$ 49.5

CDC offset these gains in its financial statements with reductions in the carrying value of its office automation investments totalling \$46.0 million to reflect an impairment of value. The carrying value of its investment in the Allan Potash mine was also reduced by \$21.1 million – an investment that was subsequently transferred to Canterra in early 1987 in exchange for 6.4 million Canterra common shares valued at \$35.9 million.

Cash Flow and Investment Spending

While Polysar's cash flow improved during 1986 as a result of improved margins and cost reductions, these gains were more than offset by reductions at Canterra as a result of the decline in prices and volumes for its products.

While the level of funding requirements at Allelix remained unchanged, the cash flow requirements at the corporate level for interest and expenses peaked in 1985 at approximately \$102.5 million annually. These cash flow requirements decreased during 1986, particularly in the fourth quarter, as CDC continued its asset disposition program and applied a portion of the proceeds from this program to reduce debt, resulting in a corresponding reduction in financing costs.

Cash Flow and Investment Spending
(millions)

	Cash flow before finance charges	Finance charges	Free cash flow	Capital expenditures
<i>1986</i>				
Canterra	\$375.9	\$201.8	\$ 174.1	\$109.7
Polysar	239.3	149.5	89.8	84.6
Allelix	(6.4)		(6.4)	
CDC Corporate	(3.4)	77.4	(80.8)	0.1
Gains	92.6		92.6	
Total	\$698.0	\$428.7	\$ 269.3	\$194.4
<i>1985</i>				
Canterra	\$544.5	\$234.1	\$ 310.4	\$220.7
Polysar	169.6	152.2	17.4	49.1
Allelix	(7.6)		(7.6)	
CDC Corporate	2.3	104.8	(102.5)	0.4
Gains	165.0		165.0	
Total	\$873.8	\$491.1	\$ 382.7	\$270.2

During 1986, consolidated finance charges of \$428.7 million absorbed 61 percent of CDC's cash flow before finance charges. Capital expenditures of \$194.4 million were 28 percent below 1985 as a result of substantial reductions in investment spending at Canterra brought about by poorer economic prospects from lower petroleum prices and reduced cash flow.

Capitalization

CDC reduced the amount of coupon-bearing capital by \$296.8 million during 1986 as a result of the sale of assets and repayment of debt. However, coupon-bearing capital – both debt and equity – totalled 92 percent of total capitalization at the end of 1986, up from 88 percent at the end of 1985 because of the impact on consolidated equity from the write-downs taken by Canterra at year-end.

Capitalization
(millions)

Year ended December 31	1986		1985	
	\$	%	\$	%
Long-term debt				
CDC	625.6		900.3	
Canterra	2,291.0		2,318.9	
Polysar	952.2		807.1	
	3,868.8	70	4,026.3	66
Minority interest	495.3	9	590.5	10
Preferred equity				
1983 Senior Preferred	125.0		125.0	
1980 Preferred	300.0		300.0	
1985 Preferred	208.0		208.0	
B Preferred	88.2		132.3	
	721.2	13	765.3	12
Total coupon-bearing capital	5,085.3	92	5,382.1	88
Common stock and retained earnings	441.3	8	754.7	12
Total capital employed	5,526.6	100	6,136.8	100

Corporate Debt

CDC reduced indebtedness at the corporate level by \$274.7 million during the past year. It holds interest-bearing investments totalling \$427.2 million which provide regular cash flow to service financing charges on indebtedness. At the beginning of 1987, CDC's annual cash flow requirements at the corporate level are approximately \$6 million to service debt, \$23 million for dividends not covered by subsidiaries, and \$8 million for corporate overheads.

CDC Corporate Debt

(millions)

Year ended December 31	1986	1985	1984
Total corporate debt	\$625.6	\$900.3	\$3,035.6
Offsets:			
Falconbridge debentures	270.8	270.8	
Canterra debentures	72.5	72.5	
Canterra advances			1,865.8
Kidd Creek advances			540.3
Subordinated debentures	83.9	85.0	80.3
Net corporate debt	\$198.4	\$472.0	\$ 549.2

Sensitivities

CDC's financial performance in 1987 will remain sensitive to a number of economic and business factors. Because of the significant proportion of floating rate coupon-bearing capital in the Corporation's financial structure, changes in interest rates can have a substantial impact on net income and free cash flow. Changes in prices and volumes of commodities sold by Canterra and Polysar can also have a significant impact on CDC's results.

Sensitivities

Variable	As at December 31, 1986	Average 1986	Change	Approximate impact on free cash flow	Approximate impact on earnings
(millions of Canadian dollars)					
Interest rates ⁽¹⁾	7.2%	7.6%	1.0%	\$35	\$20
Prices ⁽²⁾					
Oil (Cdn. \$/bbl) ⁽³⁾	20.83	19.65	\$1/bbl	7	4
Gas (Cdn. \$/mcf) ⁽³⁾	1.89	2.34	10¢/mcf	5	3
Sulphur (Cdn. \$/tonne)	119.79	142.41	\$10/tonne	8	5
Ethylene (Cdn. \$/lb)	0.19	0.21	1¢/lb	9	5
Styrene (Cdn. \$/lb)	0.31	0.28	1¢/lb	6	3

⁽¹⁾ Average of interest rates paid by CDC on consolidated indebtedness. At December 31, 1986, the 90 day London Interbank Offered Rate was 6.69%, the Canadian Prime Rate was 9.75% and the U.S. Base Rate was 7.5%.

⁽²⁾ These products are sold in markets in which prices are generally denominated in U.S. dollars. This table reflects prices received.

⁽³⁾ Reflects the impact on CDC from Canterra only. Polysar is a large consumer of natural gas, gas condensates and oil.

This summary of the significant accounting policies of Canada Development Corporation (the "Corporation") is presented to assist the reader of the financial statements. These accounting policies are in conformity with accounting principles generally accepted in Canada which are also in conformity with the historical cost accounting standards of the International Accounting Standards Committee.

Principles of Consolidation

The consolidated financial statements incorporate the financial position, operating results and changes in financial position of the Corporation and its subsidiary companies, Polysar Limited and Canterra Energy Ltd. and their subsidiaries. The CDC Data Systems companies are not consolidated (note 2).

Canterra Energy Ltd. conducts substantially all of its oil, natural gas and sulphur exploration and production activities on a joint venture basis and the accounts reflect the Corporation's proportionate interest in such activities.

The Corporation accounts for its investments in former subsidiaries, including Kidd Creek Minerals Ltd. and Sentrol Systems Ltd. and companies in which it has significant influence, including CDC Life Sciences Inc., on an equity basis. Other long-term investments are accounted for by the cost method.

Foreign Currency Translation

The results of integrated foreign subsidiaries are translated using the temporal method. Under this method, monetary assets and monetary liabilities of foreign integrated operations and long-term debt of the Corporation are translated at the rate of exchange in effect at the balance sheet date. Non-monetary assets and liabilities are translated at the rates prevailing when they were acquired or incurred. Corresponding revenue and expenses, except depreciation, depletion and amortization, are translated at rates in effect during the year. Gains or losses resulting from this translation method are included in the consolidated statement of income.

To the extent that U.S. dollar long-term debt is hedged by future U.S. dollar denominated revenue streams, the foreign exchange exposure is deferred and included in the consolidated statement of income in the period when repayments occur. Gains or losses on unhedged debt are deferred and amortized over the life of the particular debt.

Assets and liabilities of foreign operations deemed to be self-sustaining are translated at the rate of exchange in effect at the balance sheet date. Corresponding revenue and expenses are translated at rates in effect during the year. Gains or losses resulting from this translation method are deferred until there is a reduction in the net investment in the foreign subsidiaries.

Inventories

Inventories are valued at the lower of cost and net realizable value.

Property, Plant and Equipment

(a) Cost

Property, plant and equipment are recorded at cost. Fixed asset additions include related financing costs incurred during major plant construction.

The Corporation follows the full cost method of accounting prescribed by the Canadian Institute of Chartered Accountants' Guideline on Full Cost Accounting in the Oil and Gas Industry, whereby all costs of acquiring properties, exploring for and developing oil, natural gas and sulphur and related reserves are capitalized and accumulated in country-by-country cost centres. Such costs include land acquisition, drilling both productive and non-productive wells, overhead expenses and financing. The net carrying amount of each cost centre is limited to a ceiling test amount which is the estimated future net revenues from proved reserves (based on current prices and costs at the balance sheet date) plus unproved properties at carrying value. The aggregate of such estimated future net revenues for all cost centres is further reduced for recurring general and administrative costs, future financing costs and income taxes (the "Enterprise ceiling test"). Any costs carried on the balance sheet in excess of these ceiling test amounts will be charged to earnings.

(b) Depreciation, Depletion and Amortization

Depreciation of plant and equipment is based on the estimated useful life of the assets from commencement of commercial production and is calculated on the straight-line method.

For oil, natural gas and sulphur operations, depletion and depreciation is provided on the unit-of-production method based on gross proved reserves in each cost centre as determined by the Corporation. Reserves are converted to equivalent units on the basis of approximate relative energy content. Costs of acquiring and evaluating unproved properties are excluded from the calculation of depletion and depreciation until it is determined that proved reserves are attributable to the properties or that impairment has occurred. Costs of acquiring and evaluating unproved properties in Western Canada and in the Canadian Frontier areas have been excluded from capitalized costs subject to depletion until determination of whether or not reserves have been proved or impairment has occurred. All dry hole costs are included in cost centres subject to depletion.

Pre-Production and Deferred Expenditures

Expenditures incurred in connection with major new production facilities are deferred and amortized from commencement of production on the straight-line basis over a period generally not exceeding ten years.

Goodwill

Goodwill arising on acquisitions is being amortized over the expected period of benefit, not to exceed forty years. If it becomes apparent that the expected value will not be realized it will be appropriately written down.

Comparative Amounts

The 1985 consolidated financial statements have been reclassified to conform to 1986 presentation.

**Consolidated
Balance Sheet**

(millions)

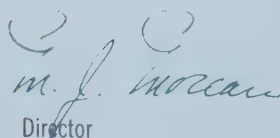
Canada Development Corporation

December 31	1986	1985
Assets		
<i>Current Assets</i>		
Cash and short-term investments	\$ 166.3	\$ 70.5
Accounts receivable	523.9	700.7
Inventories (note 1)	363.6	473.8
Other current assets	12.3	10.9
	<u>1,066.1</u>	<u>1,255.9</u>
<i>Long-Term Investments (note 2)</i>	645.7	929.0
<i>Property, Plant and Equipment (note 3)</i>	4,086.1	4,427.6
<i>Other Assets (note 4)</i>	526.4	567.3
	<u>\$6,324.3</u>	<u>\$7,179.8</u>
Liabilities		
<i>Current Liabilities</i>		
Short-term loans	\$ 162.1	\$ 306.3
Accounts payable and accrued liabilities	371.9	414.3
Long-term debt due within one year	105.5	142.8
	<u>639.5</u>	<u>863.4</u>
<i>Long-Term Debt (note 5)</i>	3,763.3	3,883.5
<i>Deferred Income Taxes</i>	263.7	322.4
<i>Interests of Minority Shareholders (note 6)</i>	495.3	590.5
	<u>5,161.8</u>	<u>5,659.8</u>
Shareholders' Equity		
<i>Capital Stock (note 7)</i>		
Preferred	721.2	765.3
Common	381.2	352.5
<i>Retained Earnings</i>	60.1	402.2
	<u>1,162.5</u>	<u>1,520.0</u>
	<u>\$6,324.3</u>	<u>\$7,179.8</u>

Contingencies (note 11)

Approved on behalf of the Board


Director


Director

Consolidated Statement of Income

(millions)

Canada Development Corporation

Year ended December 31	1986	1985
<i>Revenue</i>	\$2,625.1	\$2,960.1
<i>Expenses</i>		
Cost and expenses before the undernoted	2,008.5	2,248.5
Depreciation, depletion and amortization	302.9	272.6
Write-down of property, plant and equipment (note 3)	357.4	—
Interest on long-term debt (note 2)	312.7	299.7
Other interest	2.6	31.7
	2,984.1	2,852.5
Income (loss) before the following	(359.0)	107.6
Income taxes (note 8)	83.1	(31.4)
Minority interest	(10.6)	(18.3)
<i>Income (loss) from operations</i>	(286.5)	57.9
Results of non-consolidated subsidiaries and affiliates (note 9)	(7.5)	(14.2)
Gain on investments (note 10)	10.8	127.2
<i>Net income (loss)</i>	(283.2)	170.9
Preferred share dividends	(57.0)	(53.1)
Net income (loss) applicable to common shares	\$ (340.2)	\$ 117.8
Per common share (note 7)		
Income (loss) from operations	\$ (9.06)	\$ 0.13
Net income (loss)	\$ (8.97)	\$ 3.17

Consolidated Statement of Retained Earnings

(millions)

Canada Development Corporation

Year ended December 31	1986	1985
<i>Retained earnings at beginning of year</i>	\$402.2	\$286.3
Net income (loss)	(283.2)	170.9
	119.0	457.2
Dividends on preferred shares	57.0	53.1
Amortization of costs of preferred share issues	1.9	1.9
	58.9	55.0
<i>Retained earnings at end of year</i>	\$ 60.1	\$402.2

Consolidated Statement of Changes in Financial Position

(millions)

Canada Development Corporation

Year ended December 31	1986	1985
<i>Operations</i>		
Income (loss) from operations	\$(286.5)	\$ 57.9
Interest expense	315.3	331.4
	28.8	389.3
<i>Non-cash items:</i>		
Depreciation, depletion and amortization	302.9	272.6
Write-down of property, plant and equipment	357.4	—
Deferred income taxes	(97.1)	31.1
Equity in earnings	2.8	(2.5)
Minority interest	10.6	18.3
<i>Cash flow before financing costs</i>	605.4	708.8
<i>Financing costs</i>		
Interest expense	315.3	331.4
Capitalized interest	16.2	65.7
Capitalized overhead costs	13.9	7.8
Dividends on preferred shares	57.0	53.1
Dividends to minority shareholders	26.3	33.1
	428.7	491.1
<i>Free cash flow</i>		
Operations	176.7	217.7
Gain on investments	92.6	165.0
	269.3	382.7
<i>Equity financing</i>		
Issue of capital stock	28.7	214.0
Redemption of preferred stock	(44.1)	—
Net investment by minority interest	(79.6)	84.8
	(95.0)	298.8
<i>Cash generated for investment activities and repayment of debt</i>	174.3	681.5
<i>Investment activities</i>		
Additions to property, plant and equipment	194.4	270.2
Changes in working capital other than cash	(243.2)	184.2
Investment in non-consolidated subsidiaries and affiliates	(231.2)	(401.6)
Additions to other assets	56.8	249.2
	(223.2)	302.0
<i>Cash generated (used) during the year</i>	\$ 397.5	\$ 379.5
<i>Cash (applied to) funded by:</i>		
Short-term debt, net of cash	\$(240.0)	\$ 0.8
Long-term debt	(157.5)	(380.3)
	\$(397.5)	\$(379.5)

Notes to Consolidated Financial Statements

Year ended December 31, 1986

Canada Development Corporation

1 Inventories

			1986	1985
(millions)	Canterra	Polysar	Total	Total
Finished goods	\$ —	\$138.9	\$138.9	\$205.9
Raw materials and work in progress	49.4	135.4	184.8	220.1
Operating and maintenance supplies	8.8	31.1	39.9	47.8
	\$58.2	\$305.4	\$363.6	\$473.8

2 Long-Term Investments

(millions)	1986	1985
Falconbridge Limited		
Shares and convertible debentures	\$338.8	\$475.0
CDC Life Sciences Inc.		
Shares (quoted market value at December 31, 1986, \$98.3 million)	32.0	45.1
Sentrol Systems Ltd.		
Shares and advances	—	30.5
CDC Data Systems Limited		
Shares and advances	57.3	96.5
Kidd Creek Minerals Ltd.		
Advances (note 5(ii))	83.9	111.4
Other mining assets	33.0	57.9
Petroleum and sulphur	28.4	44.5
Petrochemicals	47.6	42.1
Venture capital and other investments	24.7	26.0
	\$645.7	\$929.0

(i) Dispositions of Subsidiaries (notes 9 and 10)

In November 1986, the Corporation sold 7.4 million common shares of CDC Life Sciences Inc. ("Life Sciences") for cash proceeds of \$125.7 million. At the same time, Life Sciences issued 2.5 million common shares. As a result of these transactions, the Corporation reduced its holdings in Life Sciences from 67% to approximately 25%.

In October 1986, the Corporation sold 6,982,378 common shares of Falconbridge Limited ("Falconbridge") and 6,982,378 one-half Deferred Payment Rights ("Rights") for cash consideration of approximately \$136.2 million. Each whole Right entitles the holder to purchase one Falconbridge common share from the Corporation for \$19.75 until December 31, 1987. The exercise of all of the Rights will result in the Corporation disposing of its interest in 3,491,189 common shares of Falconbridge. At December 31, 1986, the Corporation's investment consists of \$270.8 million of 8.5% convertible subordinated debentures and a secured interest in \$68.0 million of common shares.

During 1986, the Corporation sold its investment in Sentrol Systems Ltd. through two transactions, in Onex Capital Corporation and in the Nanisivik Mine for cash proceeds of \$34.2 million, \$17.2 million and \$11.0 million, respectively.

In December 1985, the Corporation sold its 100% interest in Kidd Creek Minerals Ltd. to Falconbridge for total consideration of \$615.0 million, consisting of cash of \$140.0 million, 10,473,568 common shares of Falconbridge (valued at \$19.50 per share) and \$270.8 million of 8.5% convertible debentures of Falconbridge (maturing March 1, 2006).

The Corporation has deconsolidated the results of these former subsidiaries from the consolidated financial statements. The investments are recorded on an equity basis.

(ii) Provisions for decline in value (notes 9 and 10)

The Corporation has determined that the carrying values of its investment in and advances to the CDC Data Systems companies exceed their estimated realizable values and accordingly they have been written down.

During 1985, the Corporation's equity investment in Savin Corporation ("Savin") was eliminated due to the recognition of its share of Savin's operating losses. At December 31, 1985, the Corporation recorded a provision of \$50.8 million against an aggregate of \$81.8 million (U.S. \$60.7 million) working capital advances to Savin. During 1986, the Corporation established a U.S. \$30.0 million senior credit facility. At December 31, 1986, advances of \$13.8 million (U.S. \$9.8 million) were outstanding pursuant to this facility.

The Corporation has decided to divest of its holdings in CDC Data Systems and its subsidiaries, Savin, AES Data Inc. and Insystec Inc. Provisions have been made which eliminate the Corporation's equity investments in CDC Data Systems and its subsidiaries. These companies have been deconsolidated. The remaining advances to Savin and AES Data Inc. are recorded at their net realizable values.

The Corporation has also determined that the carrying value of its other mining assets (principally its 40% interest in Allan Potash Mine) exceeds its net realizable value and accordingly, has been written down.

(iii) Interest income related to Falconbridge and Kidd Creek Minerals Ltd. of \$30.0 million (1985, \$30.4 million) has been included as a reduction of interest on long-term debt in the consolidated statement of income.

3 Property, Plant and Equipment

			1986	1985
(millions)	Cost	Accumulated depreciation	Net	Net
Petroleum and sulphur	\$3,684.8	\$ 973.1	\$2,711.7	\$3,072.1
Petrochemicals	2,119.5	747.5	1,372.0	1,352.7
Corporate	4.8	2.4	2.4	2.8
	\$5,809.1	\$1,723.0	\$4,086.1	\$4,427.6

(i) Petroleum and sulphur includes costs of unproved properties excluded from depletion as follows:

			1986	1985
(millions)	Western Canada and Other	Frontier	Total	Total
Balance at beginning of year	\$214.5	\$439.5	\$654.0	\$763.2
Acquisitions	15.4	—	15.4	33.8
Exploration	—	12.0	12.0	21.6
Capitalized financing costs	14.8	—	14.8	65.6
Transfer to depletion base	(35.1)	(357.0)	(392.1)	(230.2)
Balance at end of year	\$209.6	\$ 94.5	\$304.1	\$654.0

(ii) The Corporation has reviewed the carrying value of its investments in property, plant and equipment in light of prevailing economic conditions, including the downturn in world oil and natural gas prices. As a result of this review, the following provisions have been recognized:

(a) Oil and Natural Gas Properties

(i) The Canadian cost centre includes proved and unproved properties. Unproved properties in the Canadian frontier, previously carried at \$439.5 million, have been assessed on the basis of expected future oil and natural gas prices, the cost of capital and economic conditions. As a result of this assessment, a value of \$94.5 million has been attributed to these unproved properties. There is no ceiling test deficiency in the Canadian cost centre.

(ii) As a result of applying the ceiling test to the United States cost centre, the net cost of the Corporation's United States cost centre was written down by \$75.2 million.

(iii) Application of the Enterprise ceiling test has resulted in a pre-tax write-down of \$207.2 million which has been allocated to the Canadian cost centre.

(b) Coal Properties

Due to continued depressed market conditions and an extended strike of the mine workers at one of the Corporation's mines, the Corporation has reassessed the value of its coal properties in the United States and provided for an impairment in the value of these properties.

(c) Real Estate

The value of real estate properties held for resale was reviewed and a provision for impairment was made.

Summary of write-down of property, plant and equipment:

(millions)		
Oil and natural gas properties		
Canada	\$207.2	
United States	75.2	
Coal		
United States	52.7	
Real estate		
Canada	10.0	
United States	12.3	
	357.4	
Deferred income taxes	(71.4)	
Minority interest	(15.3)	
	\$270.7	

4 Other Assets

(millions)	1986	1985
Deferred foreign exchange	\$336.6	\$354.8
Pre-production and deferred expenses	86.1	98.9
Goodwill	59.0	63.6
Cost of long-term financings	28.1	32.5
Long-term receivables	16.6	17.5
	\$526.4	\$567.3

During the next five fiscal years, pre-production and deferred expenses and goodwill are expected to be amortized to income at the rate of \$28.0 million annually.

5 Long-Term Debt

(millions)	1986	1985
<i>Canada Development Corporation</i>		
Floating rate syndicated loan, secured (United States dollars)		
repayable 1987 through 1990	\$443.4	\$735.7
Subordinated debentures, due 1993 (United States dollars)	83.9	85.0
6.125% Notes, due 1990 (Swiss francs)	85.6	67.8
8% Notes, due 1992	12.7	11.8
	625.6	900.3
<i>Canterra Energy Ltd.</i>		
Floating rate syndicated loan, repayable 1987 through 1997 (United States dollars)	1,646.3	1,666.5
Floating rate bank loans, due 1988 to 1992 (United States dollars)	247.6	385.0
8.5% Convertible subordinated debentures, due 2000	150.0	150.0
Floating rate bank loans, due 1990	9.9	37.4
5.75% Notes, due 1986 (Swiss francs)	—	28.3
5.625% Notes, due 1992 (Swiss francs)	107.0	—
6.75% Bearer bonds, due 1992 (Deutsche marks)	69.1	—
10.25% Mortgage, due 1995	13.6	13.8
Customer prepayments	34.6	37.4
Other	12.9	0.5
	2,291.0	2,318.9
<i>Polysar Limited</i>		
Floating rate credit facility, due 1988 through 1992	236.4	245.2
Floating rate term loan, due 1987 through 1998	50.5	30.0
9% Sinking fund debentures, due 1987 through 1993	22.9	23.7
7.5% Sinking fund debentures, due 1987	5.2	5.2
Floating rate bank loans, due 1987 to 1991	53.7	54.7
Floating rate term loan, due 1986	—	50.0
In United States dollars		
Floating rate credit facility, due 1988 through 1992	204.3	67.1
Floating rate term loans, repayable 1987 through 1999	127.9	99.5
6.27% average rate, Notes and mortgages, repayable through 2003	14.9	16.7
9.5% Debentures, due 1986	—	68.5
In other currencies		
9.375% Debentures, due 1993 (ECU currency)	89.1	—
8.25% Debentures, repayable 1991 (Belgian francs)	41.0	—
Fixed and floating rate term loan, repayable 1987 through 1999	86.5	77.4
Floating rate multi-currency term loan, repayable 1988 through 1992	—	53.9
Other	19.8	15.2
	952.2	807.1
Long-term debt at current rates of translation	3,868.8	4,026.3
Less principal due within one year	105.5	142.8
	\$3,763.3	\$3,883.5

(i) The Corporation's floating rate syndicated loan bears interest at a rate of three-quarters of one percent over the London Inter-bank Offered Rate (LIBOR). It is secured by the pledge of substantially all of the common shares of Canterra Energy Ltd. and Polysar Limited, a secured interest in certain common shares of Falconbridge, the common shares of CDC Life Sciences Inc. and the convertible subordinated debentures of Falconbridge owned by the Corporation.

Canterra's floating rate syndicated loan bears interest at a rate of five-eighths of one percent over LIBOR, increasing to LIBOR plus three-quarters of one percent in 1987.

(ii) The Corporation's subordinated debentures bear interest at the rate of 7.5% until March 31, 1989 and thereafter to maturity at the rate of 11%. Each U.S. \$100,000 principal amount of debentures carries the right to acquire silver until March 31, 1987 at the rate of 7,188 troy ounces of silver, to March 31, 1988 at the rate of 7,019 troy ounces of silver, and to March 31, 1989 at the rate of 6,755 troy ounces of silver, in each case for U.S. \$100,000. The right to acquire silver expires after March 31, 1989. The debentures are retractable at the option of the holder at the time and to the extent the right to acquire silver is exercised. The Corporation has contracted with Kidd Creek Mines Ltd. for the latter company to meet these obligations, which are in turn supported by the undertaking of Falconbridge. Kidd Creek Mines Ltd. agreed to deliver silver pursuant to the advances by the Corporation to Kidd Creek Mines Ltd.

(iii) The total sinking fund requirements and long-term debt due in each of the next five fiscal years are as follows:

1987	\$105.5 million;
1988	\$201.4 million;
1989	\$262.7 million;
1990	\$902.0 million;
1991	\$551.1 million.

(iv) The agreements for the syndicated loans require the maintenance of certain financial measurements which have been adhered to at December 31, 1986.

6 Interests of Minority Shareholders

(millions)	1986	1985
<i>Preferred equity</i>		
Polysar Limited		
First Preferred	\$ —	\$ 44.2
Third Preferred	180.8	187.8
Polysar Holdings (a subsidiary)	56.7	85.0
Petrosar Limited (a subsidiary) Class A	240.0	240.0
	477.5	557.0
<i>Common equity</i>	17.8	33.5
	\$495.3	\$590.5

(i) Petrosar's Class A redeemable preference shares bear a cumulative dividend at an annual rate of 1.35% plus 52% of the average of certain Canadian banks' prime rates. These shares are redeemable in the amount of \$60.0 million in 1989 and \$180.0 million in 1990.

(ii) Polysar's \$44.2 million First Preferred Shares bear a cumulative dividend of 15.5%. Polysar repurchased the First Preferred Shares on July 1, 1986.

In 1985, Polysar issued \$187.8 million of Third Preferred Shares for cash. The Third Preferred Shares bear a cumulative cash or stock dividend equal to the lower of 55% of the average of a Canadian bank's prime rate or 8%, if certain earnings levels are achieved each year. The dividend is non-cumulative otherwise. Redemptions of \$59.0 million are required in 1995, and the balance is redeemable in approximately equal amounts from 1996 through 2010 inclusive. Earlier redemptions may be required

under certain conditions. Redemptions during the year totalled \$7.0 million. There are no voting rights attached to these preferred shares.

Polysar Holdings' \$85.0 million redeemable preferred shares bear a cumulative dividend of 1.25% plus one-half the prime rate of a Canadian bank. Redemptions are required to be made in equal annual amounts through 1988 inclusive. Redemptions during the year totalled \$28.3 million.

7 Capital Stock

(i) Authorized

Senior Preferred

20 million shares without par value with stated capital not exceeding \$200.0 million.

Public Preferred

130 million shares without par value with stated capital not exceeding \$650.0 million.

Preferred

30 million shares without par value with stated capital not exceeding \$150.0 million.

Common

200 million shares without par value

(ii) Issued

(millions)	1986	1985
<i>Senior Preferred</i>		
5,000,000 cumulative, redeemable, retractable shares, 1983 issue	\$ 125.0	\$ 125.0
<i>Public Preferred</i>		
15,000,000 cumulative, redeemable, convertible voting shares, 1980 issue	300.0	300.0
8,320,000 floating rate cumulative, redeemable, exchangeable shares, 1985 issue	208.0	208.0
<i>Preferred</i>		
881,748 (1985, 1,323,019) cumulative, redeemable, convertible, voting Class B shares	88.2	132.3
	721.2	765.3
<i>Common</i>		
42,082,500 shares (1985, 37,448,431)	381.2	352.5
	\$1,102.4	\$1,117.8

The 1983 issue of senior preferred shares carry the right to receive preferred cumulative dividends at an annual rate equal to the greater of Cdn. \$2.35 per share and the Canadian dollar equivalent of U.S. \$1.92 per share based on the prevailing rate of exchange for the United States and Canadian dollar on the record date for the payment of each dividend or if no such record is set, on the date such dividend should have been paid in accordance with the share condition. Dividends on these shares are payable in Canadian currency or, at the request of their holders, in U.S. currency. These shares are redeemable at the option of the holder on June 1, 1990 at \$25 plus accrued and unpaid dividends. These shares are redeemable by CDC after June 1, 1990. The holders of the 1983 issue of senior preferred shares are not entitled to notice of or to attend or vote at meetings of shareholders. Each 1983 senior preferred share carries one currency purchase warrant which entitles the holder to purchase on June 1, 1990 the sum of U.S. \$20.39 on payment of the sum of Cdn. \$25.00.

The Class B preferred shares are redeemable at the option of the holder through March 31, 1988 at \$100 per share. They are redeemable at the option of the Corporation at \$100 per share. Each Class B preferred share may be converted at any time at the

option of the holder into ten common shares. During the year, 441,256 Class B preferred shares were redeemed for \$44.1 million and 15 (1985, 2,739) were converted into 150 (1985, 27,390) common shares.

The 1980 issue of preferred shares are redeemable at the option of the Corporation at \$20.80 per share reducing by 20¢ per year until October 15, 1990 when they become redeemable at \$20 per share. Each 1980 preferred share may be converted at the option of the holder into 1.27 common shares at any time until October 15, 1990.

The 1985 issue of preferred shares carry the right to receive preferred cumulative dividends at an annual rate equal to the rate obtained by subtracting 1% from the average prime rate of a Canadian bank and multiplying the result by 0.55, subject to a minimum rate of 5% and a maximum rate of 7%. The Corporation may redeem the shares at any time for \$25 per share but must redeem them in approximately equal amounts from 1992 through 1998 inclusive. The Corporation, at its option, may exchange all or a portion of the preferred shares for subordinated debentures either of itself or of a subsidiary approved by the shareholders. If such exchange occurs, each 1985 preferred share carries a common share purchase warrant entitling the holder to purchase 0.24 common shares, at \$15.75 per share prior to June 30, 1990 increasing thereafter depending on the common share market value.

At meetings of shareholders, holders of Class B preferred shares are entitled to ten votes per share and holders of the 1980 preferred and the common shares are entitled to one vote per share.

The Corporation's floating rate syndicated loan includes certain restrictions limiting dividends on common shares under certain circumstances.

(iii) Issued during the year

In 1986, 633,919 common shares (1985, 696,238 shares) were issued for an aggregate consideration of \$4.7 million (1985, \$6.0 million) under the Shareholder Dividend Reinvestment and Share Purchase Plans.

The Corporation issued 4,000,000 common shares for cash of \$24.0 million on December 31, 1986 in connection with the sale of share purchase tax credits.

(iv) At December 31, 1986, the Corporation had granted under the 1985 Employee Stock Option Plan options to purchase 1,422,550 common shares at exercise prices ranging from \$5.875 to \$9.875 per share. In 1986, options to purchase 356,500 common shares were granted. These options expire at various dates to September 1996.

(v) Common shares reserved

At December 31, 1986, common shares were reserved for issuance as follows:

Conversion of Class B preferred shares	13,230,050
Conversion of 1980 issue of public preferred shares	19,050,000
Dividend Reinvestment and Share Purchase Plans	773,245
Employee Share Purchase and Stock Option Plans	1,476,428
Purchase warrants attached to 1985 issue of preferred shares	1,996,800
	<hr/> 36,526,523

(vi) Net income (loss) per common share

Net income (loss) per common share is based on the weighted average number of common shares outstanding during the year.

8 Income Taxes

The provision for income taxes in the consolidated statement of income reflects an income tax rate which differs from the Canadian corporate tax rate for the following reasons:

(millions)	1986	1985
Income (loss) before income taxes	\$(359.0)	\$107.6
Income tax recovery (provision) at expected rate of 51.0%	\$ 183.1	\$(54.9)
Decrease (increase) in taxes resulting from:		
Non-allowable depletion and depreciation	(28.4)	(15.7)
Write-down of property, plant and equipment	(91.7)	—
Non-deductible crown charges net of allowances	(20.8)	(41.6)
Foreign subsidiaries taxed at different rates	42.5	39.2
Manufacturing and processing tax credit	1.5	8.0
Application of previously unrecognized losses	—	9.2
Provincial tax rates different from expected	(12.0)	7.9
Inventory allowance	0.6	4.0
After-tax earnings of equity investments	3.4	3.1
Other	4.9	9.4
Income tax recovery (provision)	\$ 83.1	\$(31.4)
Current	\$ (15.9)	\$ (3.1)
Deferred	99.0	(28.3)
	\$ 83.1	\$(31.4)

9 Results of Non-Consolidated Subsidiaries and Affiliates (note 2)

(millions)	1986	1985
CDC Life Sciences Inc.	\$10.8	\$ 8.2
CDC Data Systems Limited	(17.1)	(33.4)
Sentrol Systems Ltd.	(1.2)	(1.2)
Kidd Creek Minerals Ltd.	—	12.2
	\$ (7.5)	\$(14.2)

10 Gain on Investments (note 2)

(millions)	1986	1985
CDC Life Sciences Inc.	\$100.4	\$ —
Kidd Creek Minerals Ltd.	—	145.4
Canterra Energy Ltd.	—	19.9
Sentrol Systems Ltd.	8.8	—
Other	2.6	—
Provisions for losses		
CDC Data Systems Limited	(46.0)	(50.8)
Other mining assets	(15.9)	—
	49.9	114.5
Income taxes	(39.1)	12.7
	\$ 10.8	\$127.2

11 Contingencies

(i) Petrosar Limited ("Petrosar"), a wholly-owned subsidiary of Polysar Limited, initiated legal proceedings against Ontario Hydro to recover damages of \$98.4 million arising from the breach in 1981 and 1982 of a sales agreement for atmospheric residual fuel oil. Ontario Hydro counterclaimed for approximately \$50.0 million in alleged overpayments for product taken during 1980, 1981 and 1982. Action has not yet been taken in respect of damages for the period January 1, 1983 to December 31, 1986.

On April 21, 1986, the Supreme Court of Ontario dismissed the Petrosar claim against Ontario Hydro for damages and granted a judgment on the Ontario Hydro counterclaim in the amount of \$25.5 million. Petrosar has appealed the judgment on grounds of substantial and important errors in law.

In the opinion of management and legal counsel, Petrosar will be successful in recovering at least the \$116.5 million recorded in its accounts receivable for the period January 1, 1981 to December 31, 1985. No income has been accrued in the accounts since December 31, 1985, pending resolution of the claim. Any resolution of the claim differing from that recorded in the accounts will be reflected in the accounts in the year in which the claim is resolved.

(ii) The Corporation and certain of its subsidiaries have been named as defendants in various other legal proceedings. These proceedings are being contested and it is not possible at this time to predict their ultimate outcome. Accordingly, no provision for liability, if any, has been made in the financial statements.

(iii) The Corporation has guaranteed repayment of banking facilities of the CDC Data Systems companies of approximately \$53.0 million at December 31, 1986.

12 Segmented Information

(i) Industry segments

The Corporation operates in the following industry segments:

(millions)	1986	1985
Revenue		
Sale of products and services		
Petrochemicals	\$2,035.1	\$2,149.8
Petroleum and sulphur	552.2	742.4
	2,587.3	2,892.2
Interest and other income	37.8	67.9
	\$2,625.1	\$2,960.1
Segment operating profit (loss)		
Petrochemicals	\$ 124.3	\$ 29.7
Petroleum and sulphur	(182.3)	356.2
Other	(11.8)	(6.1)
	(69.8)	379.8
Interest and other income	37.8	67.9
Corporate expenses	(11.7)	(8.7)
Interest expense	(315.3)	(331.4)
Income taxes	83.1	(31.4)
Minority interest	(10.6)	(18.3)
Results of non-consolidated subsidiaries and affiliates	(7.5)	(14.2)
Gain on investments	10.8	127.2
Net income (loss)	\$ (283.2)	\$ 170.9
Identifiable assets		
Petrochemicals	\$2,334.1	\$2,413.3
Petroleum and sulphur	3,267.9	3,662.7
	5,602.0	6,076.0
Long-term investments	645.7	929.0
Corporate assets	76.6	174.8
Total assets	\$6,324.3	\$7,179.8
Additions to property, plant and equipment		
Petrochemicals	\$ 84.6	\$ 49.1
Petroleum and sulphur	109.7	220.7
Corporate	0.1	0.4
	\$ 194.4	\$ 270.2
Depreciation, depletion and amortization		
Petrochemicals	\$ 116.5	\$ 103.8
Petroleum and sulphur		
Operations	174.6	162.7
Write-down of property, plant and equipment	357.4	—
Corporate	11.8	6.1
	\$ 660.3	\$ 272.6

(ii) Geographic Segments

The Corporation considers its three geographic segments to be Canada, the United States, and Europe and the rest of the world. Financial information with respect to these segments is as follows:

(millions)	1986	1985
Revenue		
Sales of products and services		
Canada	\$1,317.9	\$1,702.1
United States	685.4	661.8
Europe and rest of world	584.0	528.3
	2,587.3	2,892.2
Interest and other income	37.8	67.9
	\$2,625.1	\$2,960.1
Transfer between geographic segments		
Canada	\$ 351.3	\$ 369.0
United States	37.5	25.1
Europe and rest of world	17.9	31.7
Eliminations	(406.7)	(425.8)
	\$ —	\$ —
Segment operating profit (loss)		
Canada	\$ (72.1)	\$ 275.6
United States	(131.6)	19.7
Europe and rest of world	137.5	82.5
Eliminations	(3.6)	2.0
	\$ (69.8)	\$ 379.8
Identifiable assets		
Canada	\$4,793.6	\$5,219.9
United States	520.7	588.4
Europe and rest of world	314.5	284.0
Eliminations	(26.8)	(16.3)
	5,602.0	6,076.0
Long-term investments	645.7	929.0
Corporate assets	76.6	174.8
Total assets	\$6,324.3	\$7,179.8

Transfers between geographic segments are accounted for at prices comparable to open market prices. Canadian operations include export sales in 1986 of \$197.8 million (1985, \$286.3 million).

(iii) Research and Development

Research and development expenditures charged to income in 1986 amounted to \$46.3 million (1985, \$31.2 million).

(iv) Supplementary Information

(a) Summary of Financial Position

	Petrochemicals		Petroleum & Sulphur		Corporate		Eliminations		Consolidated	
(millions)	1986	1985	1986	1985	1986	1985	1986	1985	1986	1985
Assets										
Current assets	\$ 785.0	\$ 860.8	\$ 256.0	\$ 265.1	\$ 48.1	\$ 145.3	\$ (23.0)	\$ (15.3)	\$1,066.1	\$1,255.9
Long-term investments	47.6	42.1	61.4	44.6	1,631.2	2,168.6	(1,094.5)	(1,326.3)	645.7	929.0
Property, plant and equipment	1,372.0	1,352.7	2,711.7	3,149.8	2.4	2.8	—	(77.7)	4,086.1	4,427.6
Other assets	194.9	212.5	302.7	325.3	28.8	29.5	—	—	526.4	567.3
	\$2,399.5	\$2,468.1	\$3,331.8	\$3,784.8	\$1,710.5	\$2,346.2	\$(1,117.5)	\$(1,419.3)	\$6,324.3	\$7,179.8
Liabilities and Shareholders' Equity										
Current liabilities	\$ 469.8	\$ 579.0	\$ 146.3	\$ 148.1	\$ 28.5	\$ 138.9	\$ (5.1)	\$ (2.6)	\$ 639.5	\$ 863.4
Long-term debt	902.8	767.1	2,307.4	2,387.4	625.6	801.5	(72.5)	(72.5)	3,763.3	3,883.5
Deferred income taxes	(19.4)	17.8	388.2	422.0	(106.1)	(114.2)	1.0	(3.2)	263.7	322.4
Minority interest	477.9	557.4	—	—	—	—	17.4	33.1	495.3	590.5
	1,831.1	1,921.3	2,841.9	2,957.5	548.0	826.2	(59.2)	(45.2)	5,161.8	5,659.8
Equity of subsidiaries	568.4	546.8	489.9	827.3	—	—	(1,058.3)	(1,374.1)	—	—
Shareholders' equity	—	—	—	—	1,162.5	1,520.0	—	—	1,162.5	1,520.0
	\$2,399.5	\$2,468.1	\$3,331.8	\$3,784.8	\$1,710.5	\$2,346.2	\$(1,117.5)	\$(1,419.3)	\$6,324.3	\$7,179.8

(b) Summary of Operations

	Petrochemicals		Petroleum & Sulphur		Corporate		Eliminations		Consolidated	
(millions)	1986	1985	1986	1985	1986	1985	1986	1985	1986	1985
Sale of products and services	\$2,035.1	\$2,149.8	\$ 552.2	\$742.4	\$ —	\$ —	\$ —	\$ —	\$2,587.3	\$2,892.2
Interest and other income	12.6	43.8	25.2	23.5	—	0.6	—	—	37.8	67.9
Total revenue	2,047.7	2,193.6	577.4	765.9	—	0.6	—	—	2,625.1	2,960.1
Costs and expenses other than the undernoted	(1,794.3)	(2,016.3)	(202.5)	(223.5)	(11.7)	(8.7)	—	—	(2,008.5)	(2,248.5)
Depreciation, depletion and amortization	(116.5)	(103.8)	(178.6)	(166.9)	(11.8)	(6.1)	4.0	4.2	(302.9)	(272.6)
Write-down of property, plant and equipment	—	—	(431.2)	—	—	—	73.8	—	(357.4)	—
Interest (net)	(110.7)	(112.2)	(173.1)	(160.8)	(31.5)	(58.4)	—	—	(315.3)	(331.4)
	26.2	(38.7)	(408.0)	214.7	(55.0)	(72.6)	77.8	4.2	(359.0)	107.6
Income taxes	22.3	48.0	34.8	(127.8)	30.3	48.4	(4.3)	—	83.1	(31.4)
Minority interest	(20.7)	(9.2)	—	—	—	—	10.1	(9.1)	(10.6)	(18.3)
Income (loss) from operations	27.8	0.1	(373.2)	86.9	(24.7)	(24.2)	83.6	(4.9)	(286.5)	57.9
Results of non-consolidated subsidiaries and affiliates	—	—	—	—	(7.5)	(14.2)	—	—	(7.5)	(14.2)
Gain on investments	—	—	—	—	10.8	127.2	—	—	10.8	127.2
Net income (loss)	\$ 27.8	\$ 0.1	\$(373.2)	\$ 86.9	\$(21.4)	\$ 88.8	\$83.6	\$(4.9)	\$ (283.2)	\$ 170.9

(c) Summary of Changes in Financial Position

(millions)	Petrochemicals		Petroleum & Sulphur		Corporate		Eliminations		Consolidated	
	1986	1985	1986	1985	1986	1985	1986	1985	1986	1985
Operating										
Income (loss) from operations	\$ 27.8	\$ 0.1	\$(373.2)	\$ 86.9	\$(24.7)	\$(24.2)	\$ 83.6	\$(4.9)	\$(286.5)	\$ 57.9
Interest expense	110.7	112.2	173.1	160.8	31.5	58.4	—	—	315.3	331.4
	138.5	112.3	(200.1)	247.7	6.8	34.2	83.6	(4.9)	28.8	389.3
Non-cash items										
Depreciation, depletion and amortization	116.5	103.8	178.6	166.9	11.8	6.1	(4.0)	(4.2)	302.9	272.6
Write-down of property, plant and equipment	—	—	431.2	—	—	—	(73.8)	—	357.4	—
Deferred income taxes	(39.2)	(53.2)	(33.8)	129.9	(28.4)	(45.6)	4.3	—	(97.1)	31.1
Equity in earnings	2.8	(2.5)	—	—	—	—	—	—	2.8	(2.5)
Minority interest	20.7	9.2	—	—	—	—	(10.1)	9.1	10.6	18.3
Cash flow before financing costs	239.3	169.6	375.9	544.5	(9.8)	(5.3)	—	—	605.4	708.8
Financing costs										
Interest expense	110.7	112.2	173.1	160.8	31.5	58.4	—	—	315.3	331.4
Capitalized interest	1.4	0.2	14.8	65.5	—	—	—	—	16.2	65.7
Capitalized overhead costs	—	—	13.9	7.8	—	—	—	—	13.9	7.8
Dividends on preferred shares	11.1	6.7	—	—	45.9	46.4	—	—	57.0	53.1
Dividends to minority shareholders	26.3	33.1	—	—	—	—	—	—	26.3	33.1
	149.5	152.2	201.8	234.1	77.4	104.8	—	—	428.7	491.1
Free cash flow										
Operations	\$ 89.8	\$ 17.4	\$174.1	\$ 310.4	\$ (87.2)	\$ (110.1)	\$ —	\$ —	\$ 176.7	\$ 217.7
Gain on investments	—	—	—	—	92.6	145.1	—	19.9	92.6	165.0
	89.8	17.4	174.1	310.4	5.4	35.0	—	19.9	269.3	382.7
Equity financing										
Issue of capital stock	—	—	—	—	28.7	214.0	—	—	28.7	214.0
Redemption of preferred stock	—	—	—	—	(44.1)	—	—	—	(44.1)	—
Net investment by minority interest	(79.6)	53.9	—	50.8	—	—	—	(19.9)	(79.6)	84.8
	(79.6)	53.9	—	50.8	(15.4)	214.0	—	(19.9)	(95.0)	298.8
	10.2	71.3	174.1	361.2	(10.0)	249.0	—	—	174.3	681.5
Investment activities										
Additions to property, plant and equipment	84.6	49.1	109.7	220.7	0.1	0.4	—	—	194.4	270.2
Changes in working capital other than cash	(95.8)	71.6	(25.3)	(4.1)	(122.1)	116.7	—	—	(243.2)	184.2
Investment in non-consolidated subsidiaries and affiliates	5.3	(7.4)	16.9	0.6	(253.4)	(394.8)	—	—	(231.2)	(401.6)
Additions to other assets	33.2	95.2	10.6	133.4	13.0	20.6	—	—	56.8	249.2
	27.3	208.5	111.9	350.6	(362.4)	(257.1)	—	—	(223.2)	302.0
Cash generated (used) during the year	\$ (17.1)	\$(137.2)	\$ 62.2	\$ 10.6	\$ 352.4	\$ 506.1	\$ —	\$ —	\$ 397.5	\$ 379.5
Cash (applied to) funded by:										
Short-term debt	\$(133.3)	\$ (28.9)	\$(70.2)	\$ (21.5)	\$ (36.5)	\$ 51.2	\$ —	\$ —	\$(240.0)	\$ 0.8
Long-term debt	145.1	(37.8)	(27.9)	1,778.9	(274.7)	(2,121.4)	—	—	(157.5)	(380.3)
Inter-company transfers	5.3	203.9	35.9	(1,768.0)	(41.2)	1,564.1	—	—	—	—
	\$ 17.1	\$ 137.2	\$(62.2)	\$ (10.6)	\$(352.4)	\$ (506.1)	\$ —	\$ —	\$(397.5)	\$(379.5)

Auditors' Report

To the Shareholders of

Canada Development Corporation

We have examined the consolidated balance sheet of Canada Development Corporation as at December 31, 1986 and the consolidated statements of income, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1986 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Toronto, Canada
February 2, 1987

Thorne Ernst & Whinney
Thorne Ernst & Whinney
Chartered Accountants

Five-Year Financial Summary

Financial Position		1986	1985	1984	1983	1982
Assets	Working capital	\$ 426.6	\$ 392.5	\$ 147.5	\$ 228.3	\$ 289.0
	Fixed assets (net)	4,086.1	4,427.6	4,288.1	4,228.2	4,005.3
	Long-term investments	645.7	929.0	1,375.3	1,456.0	1,378.8
	Other assets	526.4	567.3	465.4	204.4	214.3
		5,684.8	6,316.4	6,276.3	6,116.9	5,887.4
Liabilities	Long-term debt	3,763.3	3,883.5	4,202.1	4,127.7	4,028.1
	Deferred income taxes	263.7	322.4	363.5	287.9	184.4
	Interest of minority shareholders	495.3	590.5	520.6	549.6	563.0
		4,522.3	4,796.4	5,086.2	4,965.2	4,775.5
Shareholders' Equity	Preferred equity	721.2	765.3	557.6	557.6	432.6
	Common equity	441.3	754.7	632.5	594.1	679.3
		\$1,162.5	\$1,520.0	\$1,190.1	\$1,151.7	\$1,111.9
Changes in Financial Position						
Derived from	Cash flow before financing charges	\$ 698.0	\$ 873.8	\$ 761.9	\$ 566.4	\$ 524.2
	Financing charges	428.7	491.1	539.5	462.0	627.1
	Free Cash Flow	269.3	382.7	222.4	104.4	(102.9)
	Issue (redemption) of capital stock	(15.4)	214.0	5.0	127.4	2.1
		253.9	596.7	227.4	231.8	(100.8)
Applied to	Investment in non-consolidated subsidiaries and affiliates	(231.2)	(401.6)	(83.8)	164.9	218.3
	Capital expenditures	194.4	270.2	169.7	290.6	407.7
	Other uses of funds	136.4	164.4	296.7	(63.5)	104.4
	Changes in non-cash working capital	(243.2)	184.2	35.0	(62.5)	(50.8)
		(143.6)	217.2	417.6	329.5	679.6
Cash generated (used) during the year		\$ 397.5	\$ 379.5	\$ (190.2)	\$ (97.7)	\$ (780.4)
Cash (applied to) funded by	Short-term debt	\$ (240.0)	\$ 0.8	\$ 9.0	\$ (90.4)	\$ 284.1
	Long-term debt	(157.5)	(380.3)	181.2	188.1	496.3
		\$ (397.5)	\$ (379.5)	\$ 190.2	\$ 97.7	\$ 780.4

Five-Year Financial Summary

(continued)

Net Income		1986	1985	1984	1983	1982
<i>Revenues</i>	Sales of products and service	\$2,587.3	\$2,892.2	\$2,743.0	\$2,531.4	\$2,737.9
	Other income	37.8	67.9	88.3	96.6	119.0
		2,625.1	2,960.1	2,831.3	2,628.0	2,856.9
<i>Expenses</i>	Cost and expenses before the undernoted	2,008.5	2,248.5	2,179.4	2,106.8	2,329.3
	Depreciation, depletion and amortization	302.9	272.6	218.5	202.6	210.5
	Write-down of property, plant and equipment	357.4	—	—	—	—
	Interest on long-term debt	312.7	299.7	282.9	215.5	294.8
	Other interest	2.6	31.7	38.8	40.5	64.1
		2,984.1	2,852.5	2,719.6	2,565.4	2,898.7
<i>Other</i>	Income (loss) before the following	(359.0)	107.6	111.7	62.6	(41.8)
	Income taxes	83.1	(31.4)	(58.2)	(53.4)	6.8
	Minority interest in income of subsidiary companies	(10.6)	(18.3)	(7.1)	(7.9)	(43.2)
<i>Income (loss) from Operations</i>		(286.5)	57.9	46.4	1.3	(78.2)
	Results of non-consolidated subsidiaries and affiliates	(7.5)	(14.2)	(14.8)	(46.3)	(47.6)
	Gain on investments	10.8	127.2	49.5	—	—
<i>Net income (loss)</i>		(283.2)	170.9	81.1	(45.0)	(125.8)
<i>Preferred share dividends</i>		(57.0)	(53.1)	(45.8)	(40.8)	(33.3)
<i>Net income (loss) applicable to common shares</i>		\$ (340.2)	\$ 117.8	\$ 35.3	\$ (85.8)	\$ (159.1)
Statistics						
<i>Per common share</i>	Earnings (loss)	\$ (8.97)	\$ 3.17	\$ 0.98	\$ (2.41)	\$ (4.52)
	Equity (fully diluted)	\$ 10.32	\$ 17.06	\$ 15.43	\$ 15.10	\$ 16.43
	Free cash flow	\$ 7.10	\$ 10.32	\$ 6.06	\$ 2.93	\$ (2.92)
	Fully diluted free cash flow	\$ 4.48	\$ 5.84	\$ 3.71	\$ 2.03	—
<i>Ratios</i>	Return on common equity	(56.9)%	17.0%	5.8%	(13.5)%	(21.0)%
	Working capital ratio	1.7:1	1.5:1	1.2:1	1.3:1	1.4:1
	Debt/equity ratio	3.3:1	2.7:1	3.7:1	3.7:1	3.6:1
	Total debt/capital ratio*	2.6:1	2.2:1	3.3:1	3.5:1	3.8:1
<i>Other</i>	Common shares outstanding					
	at year end	42,082,500	37,448,431	36,724,803	35,688,366	35,382,010

*The ratio of the aggregate amount of total debt and dividend paying preferred shares of subsidiaries to the aggregate amount of shareholders' equity, deferred taxes and non-dividend paying minority interests.

CDC Equity

CDC has four classes of shares, three of which entitle their holders to vote at shareholders' meetings.

Common shares

At the end of 1986, there were 42,082,500 common shares outstanding which were registered in the name of 12,384 holders. The Government of Canada is the registered owner of 8,886,344 common shares, representing 21.12 percent of those outstanding and carrying 13.48 percent of the votes at shareholders' meetings. During 1986, 9,204,864 common shares were traded on stock exchanges. Share prices fluctuated from a high of \$11 3/8 in January to a low of \$5 6/8 in September, closing the year at \$6.00. No dividends are paid on the common shares.

1983 Senior Preferred Shares

There was 5,169 registered holders of 5,000,000 non-voting 1983 Senior preferred shares. Each of these shares carries a non-detachable warrant which entitles its holder to purchase, on June 1, 1990, the sum of \$20.39 (U.S.) on payment of \$25 (Canadian). A quarterly cash dividend – payable on the first of March, June, September and December – is paid at a rate equal to the greater of 58.75 cents (Canadian) per share and the Canadian dollar equivalent of 48 cents (U.S.) per share based on the prevailing rate of exchange between the two currencies on the record date. The dividend is payable in Canadian currency or, if required by the holder, in United States dollars. During 1986, the shares traded at a high of \$28 in January and a low of \$23 1/8 in September, closing at 25. There were 1,094,433 shares traded, representing 21.9% of the total outstanding.

1980 Preferred Shares

At the end of the past year, there were 16,481 holders of CDC's 15,000,000 1980 preferred shares. Each 1980 preferred share carries one vote and is convertible at the option of the holder until October 15, 1990, into 1.27 common shares for each 1980 share. Based on the issue price of \$20, the effective conversion price is \$15.75 per common share. Each 1980 preferred share pays a quarterly dividend of 38 cents on the first of February, May, August and November. During 1986, 3,609,350 of the 1980 preferred shares were traded, representing 24.1 percent of those outstanding; the high price for the year was \$17 3/4 in January while a low of \$13 1/4 was recorded in October, with closing at \$14 3/8.

Class B Preferred shares

The Corporation had outstanding 881,748 Class B preferred shares at the end of 1986, which were registered in the names of 7,232 holders. Each Class B share carries 10 votes at shareholders' meetings, and is convertible at any time, at the holder's option, into 10 common shares. A quarterly dividend of \$2 is paid on the first of January, April, July and October. Class B shares are redeemable at the option of their holders at the original issue price of \$100 each from October 2, 1985, to March 31, 1988. During 1986, 348,783 Class B shares were traded. The high of \$114.50 was reached in January and a low of \$98 in June, with the year's closing at \$99 3/4.

Shareholder Investment Program

CDC has an investment program which offers its shareholders two convenient plans for purchasing additional common shares – reinvesting dividends at 95 percent of average market price or making cash contributions at 100 percent of average market price. The program has a number of advantages and, to help explain these and how to participate, a detailed offering circular is available from CDC's Shareholder Services Department, 444 Yonge Street, Suite 200, Toronto, Ontario, M5B 2H4 (Phone: 416-598-7300).

The shareholder investment program continues to be well received by CDC shareholders. At year end, 4,780 shareholders were participating, representing 15.9% of all registered holders. Under the program, CDC issued 633,919 new common shares in 1986 for a total consideration of \$4.7 million. The weighted average price paid by shareholders reinvesting their dividends was \$7.55 per share while the value of shares purchased with cash contributions was \$7.95.

Corporate Information

A. John Ellis
*Honorary Chairman and
Director Emeritus*
Vancouver, British
Columbia

Directors

Philippe de Gaspé
Beaubien
*Chairman, President and
Chief Executive Officer*
Télémedia Corporation
Montreal, Québec

John Bruk
Chairman
Asia Pacific Foundation of
Canada
Vancouver, British
Columbia

Donald G. Campbell
Chairman
Maclean-Hunter Limited
Toronto, Ontario

E. Kendall Cork
*Senior Vice President and
Treasurer*
Noranda Inc.
Toronto, Ontario

Pierre Côté⁽¹⁾
Chairman of the Board
Celanese Canada Inc.
Montreal, Québec

H. Anthony Hampson⁽¹⁾
*Deputy Chairman and Chief
Executive Officer*
Canada Development
Corporation
Toronto, Ontario

Gordon F. Hughes
Chairman
Ocean Company Limited
Windsor, Nova Scotia

Bernard F. Isautier⁽¹⁾
*President and Chief
Operating Officer*
Canada Development
Corporation
Toronto, Ontario

Patrick J. Keenan⁽¹⁾
*Chairman and Chief
Executive Officer*
Keewhit Investments
Limited
Toronto, Ontario

Bernard Lamarre⁽²⁾
*Chairman and Chief
Executive Officer*
Lavalin Inc.
Montreal, Québec

Mrs. Mary Lamontagne⁽²⁾
Corporate Director
Québec City, Québec

Donald D. Lougheed
Corporate Director
Calgary, Alberta

Paul E. Martin
*President and Chief Executive
Officer*
The CSL Group Inc.
Montreal, Québec

John R. McCaig⁽¹⁾
*Chairman and Chief
Executive Officer*
Trimac Limited
Calgary, Alberta

William C.Y. McGregor⁽²⁾
Corporate Director
Winnipeg, Manitoba

J. William E. Mingo⁽²⁾
Partner
Stewart, MacKeen &
Covert
Halifax, Nova Scotia

Maurice J. Moreau⁽²⁾
Corporate Director
Victoria, British Columbia

Edward G. Rowe
President
York Centre Corporation
Toronto, Ontario

John G. Sheppard⁽¹⁾
Vice Chairman
Dofasco Inc.
Hamilton, Ontario

Allan F. Waters⁽¹⁾
President
CHUM Limited
Toronto, Ontario

William P. Wilder
Chairman of the Board
The Consumers' Gas
Co. Ltd.
Toronto, Ontario

Officers

Pierre Côté
Chairman of the Board

Patrick J. Keenan
Vice Chairman

John R. McCaig
Vice Chairman

H. Anthony Hampson
*Deputy Chairman and Chief
Executive Officer*

Bernard F. Isautier
*President and Chief
Operating Officer*

Gerald T. McGoey
*Executive Vice President and
Chief Financial Officer*

Brian M. King
Senior Vice President

Claude R. Marchand
*Senior Vice President and
Secretary*

Jerry W. Bliley
Vice President

Roger E. Brownell
Vice President and Treasurer

Nigel G.D. Gray
*Vice President and General
Counsel*

J. Patrick Howe
*Vice President, Corporate
Affairs*

Norma Michael
Vice President
*Business Development and
Planning*

Daniel P. Owen
Vice President

⁽¹⁾ Executive Committee

⁽²⁾ Audit Committee

Corporate Office

The principal office of CDC is located at Suite 200, 444 Yonge Street, Toronto, Canada M5B 2H4 (Telephone 416-598-7200).

Inquiries

CDC maintains its own shareholder records and pays all dividends directly. Inquiries regarding change of address, stock transfer, dividends or other shareholder matters should be made to Shareholder Services Department at the corporate office (416-598-7300).

Listing and Transfer Agent

CDC common shares (Symbol: CDC), as well as Class B (Symbol: CDC.PR.B) and 1980 Preferred Shares (Symbol: CDC.PR.C) are listed on the Montreal, Toronto and Vancouver exchanges. The 1983 Senior Preferred Shares (Symbol: CDC.PR.D) trade on the Toronto Stock Exchange. The transfer agent for these classes of CDC shares is National Trust Company at its principal offices in Vancouver, Calgary, Winnipeg, Toronto and Montreal, and its agent, Royal Trust Company, at its principal office in Halifax.

Annual Meeting

The annual meeting of shareholders will be held at 11:00 a.m. on Wednesday, May 27, 1987 at Commerce Hall in the Commerce Court, King and Bay Streets, Toronto, Canada.

Other Annual Reports

Some CDC companies produce annual reports outlining in more detail their operations. Annual reports are available from Canterra, Falconbridge, Polysar and CDC Life Sciences by writing to CDC's corporate office.

Version française

Pour obtenir la version française du présent rapport, prière d'écrire à CDC.

